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These *Fact Sheets* on various fiscal and economic issues are intended as background information for the consultations leading to the 1995 budget. They are based on two key documents. *A New Framework for Economic Policy* outlines the government's broad strategy to promote economic growth and job creation. *Creating a Healthy Fiscal Climate* updates the fiscal and economic situation since the last budget in February 1994, reaffirms the government's deficit reduction targets and provides information on government spending and revenues. While these Fact Sheets cover relevant information, they are not exhaustive. For further information, interested readers should consult the key documents or the Government of Canada's Main Estimates. Publications/documents can be obtained from the:

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The Deficit, the Debt and Canada's Economy

How do the deficit and debt affect the economy?

A rising burden of debt, driven upward by high deficits, threatens economic growth in a number of ways, all linked in a "vicious circle" through:

...higher interest rates

Based on experience in other countries, investors fear the government will attempt to "print money" to finance the deficit, leading to higher inflation and thus repayment of debt in inflated (i.e. less valuable) dollars.

The fear of higher inflation leads to higher interest rates as potential lenders demand more protection against inflation and – in the case of foreign lenders – the risk of currency depreciation.

...less investment, growth and job creation

Higher interest rates, in turn, dampen investment, economic growth and job creation. This causes government spending to increase (e.g., higher UI payouts) and depresses revenue, all of which increases deficits and debt.

...reduced confidence in the future

Higher interest rates add directly to public debt charges and thus to more rapidly compounding debt and deficits. This heightens fears of investors about the safety of their capital and leads to still higher risk premiums and interest rates.

High deficits raise the fear of higher future taxes, further dampening investment, growth and job creation.

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...weakened economic sovereignty and fiscal flexibility

As government relies increasingly on borrowing from foreign creditors to pay interest on the debt, the country's economic sovereignty is weakened. At the same time, government loses the fiscal flexibility to respond with appropriate measures in the event of downturns in the economy or natural disasters – because it has to pay more and more debt interest.

...lower growth potential for the economy

Today's deficits are primarily paying the borrowing costs of past consumption, and not investment, and are therefore doing little to boost the future growth potential of the economy.

Deficits represent a burden on future Canadians, who will have higher taxes and lower disposable incomes as a result. This could be compared to parents bequeathing a mortgage to their children but without the house to go with it.

This burden is likely to be compounded by demographic change – a much smaller proportion of working-age Canadians will have to support a growing proportion of retirees.

Isn't growth in the economy supposed to balance out the rise and fall of deficits over time?

Yes, in principle – if expenditures and revenues have been in reasonable balance over a period of time. But that balance has been lost because the federal government has experienced a continuing string of deficits for the past 25 years in good as well as in bad years.

A large debt has accumulated and debt interest is now a continuing source of upward pressure on the deficit. As a result, the deficit will not be eliminated by economic growth – even at the peak of the economic cycle. That is why direct action is needed to reduce the deficit.

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Canada's Deficit and Debt Challenge

What is the difference between deficit and debt?

The "deficit" is the shortfall that occurs when government spending exceeds revenues in any given year. The public "debt" is the total of all past deficits and surpluses since Confederation. The federal government has been adding to the debt – that is, running deficits – in every one of the last 23 years.

How big is the deficit?

The deficit was $42 billion in 1993-94 and is expected to decline to no more than $39.7 billion in 1994-95 – the target set out in the 1994 budget.

How big is the debt?

Canada's federal debt totalled over $508 billion at the end of last March (the fiscal year or accounting period is from April 1 to March 31) and is increasing at the rate of some $3 billion each month. Interest payments on the debt are expected to total $44.3 billion in 1994-95. Without these payments there would be no deficit – indeed, there would be a $4.6 billion surplus.

If the debts of the provinces are included, Canada's total government debt exceeds $700 billion. This is equivalent to 100 per cent of GDP – the highest public debt, relative to the size of the economy, of any major industrial country except Italy.

What will the government do about the deficit?

The ultimate goal is to eliminate the deficit. As an interim deficit target, the government is committed to reducing the deficit to 3 per cent of GDP – about $25 billion – by 1996-97. Setting and reaching this interim target sends an important signal to everyone that the government is committed to dealing with the fiscal problem. It will also be the lowest deficit relative to the size of the economy in 20 years.

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Why does it matter whether the target of 3 per cent of GDP is reached?

The target is extremely important. For many years, the debt relative to the size of the economy (debt-to-GDP ratio) has been rising – from 17 per cent in the mid-1970s to more than 71 per cent today. With the deficit reduced to 3 per cent of GDP in 1996-97, an important turning point will be reached. The debt-to-GDP ratio will drop – only the second time this will have occurred since 1974-75.

Reducing the deficit from almost 6 per cent last year to 3 per cent in 1996-97 will put the government clearly on a path to eliminating the deficit.

Why is a growing debt such a problem?

A growing debt means that more and more tax dollars go towards paying the interest on the debt and cannot be used for government programs or services or to reduce the tax burden. For example, last year more Canadian tax dollars were used to pay interest on the debt than were spent on other government programs – more than was spent on health care, welfare, programs for seniors, in fact more than was spent to run the entire government.

The growing demand for borrowed money pushes up interest rates and makes Canada more reliant on foreign sources of financing. The net amount owed by all levels of government and the private sector to foreign lenders is $313 billion – by far the highest level of external debt, relative to GDP, of any major industrial nation. Of this, over $100 billion is owed by the federal government. The interest on this debt simply leaves Canada – a direct blow to our standard of living. These debts erode Canada's economic sovereignty, as economic policy must increasingly take into account the reaction of financial markets.

Couldn't we just "grow" our way out of debt?

No. While higher economic growth will ease the fiscal problem, Canada has reached a point where growth alone is not enough. In fact, on the basis of plausible economic assumptions, even the deficit would not be eliminated let alone the debt.

What kinds of action are needed to reduce the deficit?

Broadly speaking, there are two kinds of budget actions that can reduce the deficit – decreasing program spending and increasing revenues. The government believes any budget action should weigh towards cuts in program spending.

The public consultations leading to the 1995 budget will play a key role in determining which actions are most appropriate. In addition, policy and program reviews announced in the last budget will identify opportunities for savings.

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Public Debt Charges

What are public debt charges?

"Public debt charges" are another name for interest payments the federal government must make on its outstanding debt.

How much are they?

$38 billion in 1993-94.

How fast are public debt charges accumulating?

$85,000 per minute, 24 hours a day.

What does that mean for Canadians?

About 33 cents of every dollar of government revenue went to pay interest last year. Looked at another way, the largest area of government spending was interest payments on the debt. It represented about 25 cents of every dollar of all federal budgetary spending. The greater the portion of budgetary spending that goes to debt charges, the less that is available for programs and services – or tax cuts. That translates into $38 billion last year that was not available for training, health care, assistance for seniors, or research.

What's the impact of higher interest rates on public debt charges?

The higher interest rates go, the greater the cost of public debt charges or "servicing the public debt". With a federal government debt of over $508 billion, the deficit is extremely sensitive to interest rate fluctuations. For example, a general, sustained increase in interest rates of one percentage point would increase the annual deficit by about $1.7 billion the first year, rising (as existing debt is rolled over) to about $3.5 billion by the fourth year.

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What is the effect of compounding interest?

Compounding interest means that, because the government must borrow to make interest payments, the public debt charges due this year get added to next year's debt. Therefore, next year interest is paid on the outstanding debt as well as on the interest due the previous year – and it goes on from there.

What effect will higher interest rates have on public debt charges this year?

Interest payments on the debt will climb from $38 billion in 1993-94 to $44.3 billion in 1994-95. Of this $6.3 billion increase, $3.3 billion is due to higher interest rates and $3 billion to compounding interest costs on existing debt.

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Canada's Growing Debt to Foreign Lenders

What is the debt to foreign lenders?

This is the money Canadians have borrowed from foreign sources. Part of the federal debt is owed to foreign lenders, and both provincial governments and Canada's private sector owe large and growing amounts to foreign sources.

How big is this debt?

The federal government owes more than $100 billion to foreign lenders. When all levels of government and the private sector are included, Canada's net debt to foreigners is more than $300 billion. This equals about 44 per cent of GDP, the highest level of foreign debt, relative to the size of our economy, of any major industrial nation. Italy is next at 12 per cent.

Why does Canada need to borrow abroad?

The simple answer is that the total borrowing needs in Canada by government and business are greater than savings generated in Canada. Canadians' savings are high enough to finance private investment, but not enough to meet both private and government borrowing needs.

What's so bad about debt owed to foreign sources compared to debt owed to Canadians?

High and growing debt owed to foreigners means that less and less of Canada's income is available to Canadians, because more and more of it, in the form of interest payments and dividends, is leaving the country. This is a direct blow to our standard of living, as government borrowing has been used largely to finance current consumption rather than productive investment.

Owing high levels of debt abroad robs Canada of its economic sovereignty. Canada loses some of its ability to pursue policies that would be in the country's best economic interests. Canada's increasing reliance on foreign funds also makes the economy more vulnerable to changes in international markets.

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Reducing the Deficit – Myths and Realities

"Surely the government could eliminate or drastically reduce the deficit by..."

...lowering interest rates

Interest rates are not determined by the government, but by investors. The Bank of Canada can influence short-term interest rates, but it can't dictate long-term interest rates or the cost of borrowing in international financial markets.

...stimulating growth with spending increases and tax cuts

Such action can be helpful only when government finances are fundamentally sound. But chronic deficits and rising debt kill jobs by pushing up taxes and interest rates and undermining confidence.

...increasing the money supply to finance the debt

Printing money to pay down the debt has been tried in other countries and has failed miserably. That's because it fuels inflation, leading to higher interest rates and higher debt servicing costs.

...simply freezing program spending at existing levels for the indefinite future

Total program spending is more than frozen, it is actually declining. Yet even as program spending declines, the cost of servicing the debt is going up faster.

...making the rich pay their fair share of taxes

The government has taken action and will continue to improve the fairness and efficiency of the personal income tax system. But increased taxation of higher income Canadians does not have as much revenue potential as is sometimes believed. Most high-income people already pay a substantial amount of tax – both in absolute terms and as a portion of income. The number of remaining tax planning opportunities – referred to by some as "loopholes" – is limited and simply increasing tax rates would probably hurt economic incentives and competitiveness.

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...making corporations pay their fair share of taxes

Measures to make the business tax structure fairer, protect revenues, and better target tax assistance to business were included in the 1994 budget, and further opportunities to enhance fairness will be sought. Corporations pay many taxes besides income tax – including capital, payroll and property tax. In 1993, for example, such taxes totalled $51 billion.

...trimming the fat from government operating costs

The entire cost of running the government and delivering programs was equal to less than half the annual deficit in 1993-94. Hence, even the most drastic cuts would have a relatively modest impact on the deficit. The government is committed to delivering services as cost-effectively as possible: the operating budgets of government departments were cut in the 1994 budget – one of more than a dozen such restraint measures in the past decade. But it is impossible to significantly reduce the cost of delivering programs without cutting the programs themselves. The government is reviewing all aspects of departmental spending to ensure that it focuses on the highest priority areas and those where the federal government is best placed to deliver services.

...eliminating social security benefits for wealthy Canadians

There are possible savings here, but they're limited. Many social programs are already targeted on the basis of income – e.g., the guaranteed income supplement, spouses allowances, the child tax benefit and the GST credit. Others, such as old age security and unemployment insurance, are reduced or recovered as income rises.

...selling off Crown corporations

There may be many good reasons for privatizing Crown corporations, but the impact on the deficit is extremely limited. The deficit would be reduced only in cases where the selling price exceeds the value at which the asset is recorded. There are few such cases at this time.

...borrowing exclusively from Canadians

The total borrowing needs of Canadian governments and the private sector are higher than Canadian savings alone can supply. If governments borrowed exclusively from Canadians, it would simply force more private sector borrowing from foreign sources, with no change in the foreign debt.

...doing as we did after the end of the Second World War, when the debt equalled a larger share of the economy than it does today

Circumstances were very different then. With demobilization, federal expenditures dropped by about three quarters – from 50 per cent of the economy to 13 per cent. Total federal spending today, including debt servicing, equals about 22 per cent of the economy, so comparable spending cuts are impossible. Equally important, the economic conditions that prevailed then were very different from those of today. Economic growth and productivity gains were much higher and real interest rates were low.

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Updating the Economic Assumptions

What are economic assumptions?

When the government makes projections of its revenues, expenditures and deficit, it must make assumptions about the future performance of the economy – about growth, interest rates and inflation, for example. These are the "economic assumptions" on which fiscal planning is based.

Why are economic assumptions so important to budget planning?

To ensure that it meets its fiscal objectives, and to maintain credibility, the government has assigned a high priority to being prudent and cautious in choosing the economic assumptions it uses for budget planning. The reason is that errors in the economic assumptions can lead to very large errors in estimates of government revenues, expenditures and the deficit.

Undue optimism about the performance of the economy can cause the government to overestimate its revenues and underestimate its expenditures, leading in turn to policy measures that are insufficient to meet its deficit targets. The result is a loss of credibility for the government, further upward pressure on interest rates, and an even more intractable fiscal problem than before, requiring yet more drastic measures.

The federal government never seems to meet its deficit targets. Why?

Forecasting the future is always difficult. In recent years, federal deficit forecasting was thrown off course by a tendency to use excessively optimistic economic assumptions.

What is so different now?

In the 1994 budget, a more prudent set of planning assumptions was used than had been the case in the past. The government used less optimistic assumptions than private sector forecasters for most key economic indicators and, in addition, set aside a larger contingency reserve than in the recent past, to deal with unforeseen circumstances.

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Then why is the deficit off target?

The government will meet its deficit target for 1994-95.

But, despite being extremely prudent, some of the assumptions in the 1994 budget have turned out to be wrong. Interest rates, for instance, have risen much higher than anyone had predicted, and those rates are expected to rise even more in the future. This volatility, triggered by developments in the United States, has been more pronounced in Canada than in other industrialized countries because of continuing concerns over deficits, debt and the political future of Quebec.

Because Canada's debt is so large – more than half a trillion dollars – relatively small increases in interest rates can mean billions in new public debt charges.

How much will the deficit be off-track because of revised economic assumptions?

The government is taking into account the fact that interest rates are volatile. The average private sector economic forecasts would imply that the 1994 budget targets would be exceeded by a) $2.3 billion in 1995-96 and b) $5 billion in 1996-97. For fiscal planning purposes, a more prudent set of economic assumptions should be considered. If interest rates were 50 basis points above the private sector average forecast, then the gap to the budget targets would be a) $3.1 billion in 1995-96 and b) $6.3 billion in 1996-97. If interest rates were a full 100 basis points above the private sector average, and nominal GDP growth were one-half a percentage point weaker each year, then the gap would be a) $4.7 billion in 1995-96 and b) $9.0 billion in 1996-97.

How will the government choose the economic assumptions to be used in planning the 1995 budget?

The government has asked the House of Commons Standing Committee on Finance, which will be conducting extensive pre-budget consultations, to consider what assumptions would be appropriate for fiscal planning purposes. The committee will invite experts before them to discuss this key issue, and their advice will be critical. The Minister of Finance will be asking the same questions in his consultations.

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Federal Government Spending

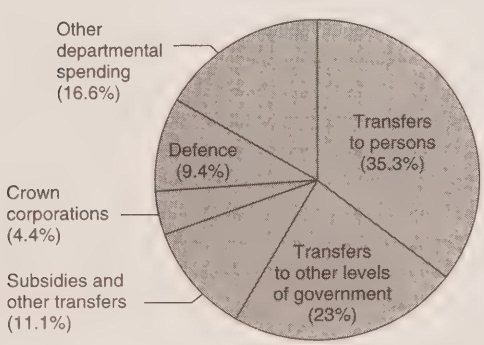
How much is the government spending?

$158 billion – Estimated spending for the 1993-94 fiscal year. This will represent about 22.2 per cent of Canada's economy. Of this, $38 billion was to pay for interest on the public debt, and the remaining $120 billion was to pay for programs.

What is program spending?

Program spending ($120 billion) is what the government spends, excluding interest payments on the public debt. It includes transfers to persons, to other levels of government, and to provide services to Canadians. In 1993-94, program spending fell under six major categories (as charted below). Dollar spending in each category is summarized on the back page.

Program spending



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Major program spending categories 1993-94

	($ billions)
Total program spending	120.0
Of which:	
Transfers to persons	
Elderly benefits	19.9
Unemployment Insurance	17.6
Veterans' pensions/allowances	1.7
Indians and Inuit	3.2
Total	42.4
Transfers to other levels of government[1]	
Established Programs Financing	
Health	7.2
Post-secondary education	2.4
Canada Assistance Plan	7.2
Equalization	7.8
Transfers to territories	1.1
Other	1.9
Total – cash	27.6
Subsidies and other transfers	
Business subsidies[2]	3.1
International assistance	2.6
Other	7.7
Total	13.4
Crown corporations	
Canadian Broadcasting Corporation	1.1
Canada Mortgage and Housing Corporation	1.9
Other	2.3
Total	5.3
Defence	11.3
All other departmental spending	20.0

[1] Transfers under Established Programs Financing and Canada Assistance Plan to other levels of government are made as a combination of cash and a transfer of tax points. Total transfers, including cash and tax transfers, are estimated at $36 billion in 1993-94.

[2] Includes transfers in 1993-94 under Industry Canada ($1.6 billion), Natural Resources ($0.4 billion), the regional agencies ($0.7 billion) and Transport Canada ($0.4 billion).

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Federal Transfers to Provinces

What are federal transfers to provinces?

The federal government provides funding to provinces and territories to ensure they have the means to deliver essential public services. These include health care, post-secondary education and social welfare services.

How much do provinces receive?

$39.8 billion – was the total value of federal funding under various transfer programs to other levels of government in 1993-94. Of this:

$24.7 billion – went to provinces and territories as cash assistance under three programs (Equalization, Established Programs Financing and Canada Assistance Plan);

$11.4 billion – was in the form of "tax points" for these three major transfer programs;

$ 3.7 billion – went to provinces, territories and municipalities under other transfer programs.

What are tax points?

Transfers come in two forms – tax points and cash. Tax points permit provinces to receive tax revenue that would otherwise flow to the federal government.

How large a source of provincial revenues are federal transfers?

25 per cent of total provincial revenues in 1993-94 came from federal cash or tax point transfers.

Since transfer programs provide varying amounts to individual provinces depending on population, economic need and other factors – the per-province amount ranges from 45 per cent of provincial revenues in Newfoundland (the highest share) to 20 per cent of British Columbia's revenues.

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What are the major transfer programs?

Equalization

$7.9 billion – was the value of federal assistance in 1993-94 under the Equalization program. This funding allows all provinces, regardless of their economic base, to provide people with reasonably comparable services at reasonably comparable tax levels.

Which provinces receive Equalization funding is determined by a formula measuring each province's revenue-raising capacity against a five-province average. Currently, seven provinces receive Equalization; Ontario, Alberta and British Columbia do not.

Established Programs Financing (EPF)

Under EPF, the federal government provides equal per-person amounts to the provinces to assist them in providing health care and post-secondary education. In 1993-94, transfers under EPF (including cash and tax points) were:

$15.1 billion – to help provinces pay for health care services. About $7.3 billion are cash transfers.

$ 6.1 billion – to help provinces pay for post-secondary education. About $2.4 billion are cash transfers.

Canada Assistance Plan (CAP)

$7.7 billion – went to provinces in cash and tax points under the Canada Assistance Plan. This program helps provinces provide social assistance and social services to needy Canadians.

For the seven less affluent provinces receiving equalization payments, CAP funding matches provincial social assistance and social services funding dollar for dollar. For Ontario, Alberta and British Columbia, the growth of CAP payments since 1990 has been limited by legislation to no more than 5 per cent yearly.

Are there any other transfers?

$3.7 billion – in funding was provided to other levels of government by the federal government in 1993-94 under a variety of other programs. These included funding to territorial governments; to municipal governments, in place of property taxes (which can't be levied on federal buildings and real estate); and for specific shared-cost programs with provinces, such as legal aid, young offenders programs, and agricultural support.

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Payments to Persons

What does the government spend on income support for individuals?

$42.4 billion in 1993-94, for elderly benefits, unemployment insurance, payments to Aboriginal people and veterans' pensions/allowances.

Federal spending on individuals accounts for over one-third of total program spending and represents the single largest category of spending. The bulk of the direct cash payments go to the elderly and the unemployed.

In addition, low- and middle-income families received $7.7 billion in tax credits under the Child Tax Benefit ($5.1 billion) and GST credit ($2.6 billion).

How much is spent on Elderly Benefits?

$19.9 billion in net income support.

More than 3.2 million seniors received Old Age Security (OAS) payments ($15 billion), the Guaranteed Income Supplement (GIS) ($4.4 billion) and Spouses' Allowance (SPA) ($0.4 billion) in 1993. All benefits are fully-indexed. GIS and SPA payments are income-tested and non-taxable. OAS payments are taxable; taxation of OAS generates $1.8 billion. In addition, OAS benefits start being recovered on the basis of individual income beginning at $53,215; $400 million is recovered annually from high-income OAS recipients.

Elderly Canadians are also eligible to claim the age and pension tax credits which are subtracted from income tax and are not included in budgetary spending. The value of these credits is $1.8 billion annually. Therefore, net benefits to the elderly, after taking into account tax measures, amounted to $19.5 billion in 1993.

Not included in this amount is $14.4 billion in retirement, disability and survivor benefits under the Canada Pension Plan. The program is financed through workers' and employers' contributions and is not part of budgetary spending.

...on the Unemployment Insurance (UI) Program?

$17.6 billion for benefits and developmental uses.

Unemployment Insurance provides temporary income support for Canadians who have lost their jobs, or who are unable to work because of maternity, parental obligations or sickness. It also provides about $1.9 billion of developmental services, including training programs, to UI claimants.

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Last year, an average of 1.3 million Canadians a month received UI benefits. UI is financed by premiums contributed by employers and employees. However, there was an accumulated deficit of $5.9 billion by the end of 1993. UI benefits are taxable as income and premiums are offset by tax credits. Claimants whose annual net income (including UI benefits) is more than a prescribed limit ($58,100 in 1993) must repay 30 per cent of those benefits that are in excess of the limit.

...on Aboriginal people?

$3.2 billion was transferred by the Department of Indian Affairs and Northern Development to Aboriginal people for a number of programs and services including education, social assistance, capital (including housing) and local and self government. Federal funding for Aboriginal people currently totals about $5 billion a year. This includes about $900 million for health services.

...on Veterans' Pensions/Allowances?

$1.7 billion for disability pensions, income support, health care and other benefits.

Benefits and services are provided to veterans and their dependants, to survivors of veterans and to eligible civilians. Neither War Veterans' Allowances nor disability benefits are taxable.

...on assistance for families?

Two large income-tested tax credits are provided to low- and middle-income families. The *Child Tax Benefit* provides a basic benefit of up to $1020 per child annually and a working income supplement of up to $500 annually. Maximum benefits are available to families with net income between $10,000 and $20,921. The working income supplement starts being reduced at $20,921. The basic credit is recovered from families whose net income exceeds $25,921 – at a rate of 5 per cent of income, for families with two or more children. The credit is fully phased out at $66,721 for one- and two-child families, at $88,621 for families with three children and at $110,521 for families with four children. The Child Tax Benefit was valued at **$5.1 billion** in 1993-94.

Additional federal support is provided through the *GST credit*. These cash payments assist low- and modest-income Canadians to offset their costs associated with the payment of GST on their purchases. The basic benefit is $199 per adult and $105 per child for those families with a net income under $25,921. The credit is reduced by 5 per cent of income over that amount and fully phased out at a family income of $35,181. The credit provided **$2.6 billion** in payments last year.

...on other social programs?

The federal government makes transfers to other levels of government in Canada to help them provide services to the Canadian public. Most of these transfers support the Canada-wide system of medicare, higher education and a network of social assistance and services. Last year, these transfers totalled $39.8 billion in both cash and tax transfers to provincial, territorial and municipal governments under major transfer programs.

About $11 billion was spent last year to provide other services to individuals through social programs administered by the federal departments of Health, Human Resources Development, Indian Affairs and Northern Development, and Citizenship and Immigration.

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Tax Expenditures

What are tax expenditures?

Canada's income tax system provides various tax deductions, deferrals, credits and income exclusions that reduce the amount of tax paid by individuals and companies. These measures were put in place to provide assistance or incentives to specific groups or activities. They include the age and pension income credits; deferred taxation of RRSPs; low tax rates for small businesses; and the non-taxation of workers' compensation benefits.

Are all credits and deductions considered tax expenditures?

There are several tax provisions that are not generally considered to be tax expenditures even though they reduce the amount of revenue collected by the government.

For example, the basic personal tax credit claimed by all individual taxpayers (with a value of $16.9 billion in 1991) is considered an intrinsic part of the basic tax rate structure.

Or there is the dividend tax credit, which reduces or eliminates the double taxation of income already taxed at the corporate level and then distributed to individuals through dividends.

How much potential revenue is involved?

There are 14 major income tax expenditures where, in each case, the revenue foregone by the federal government is estimated to exceed $300 million. There are also many other, less costly tax expenditures.

However, it is important to realize that the estimated cost of particular tax expenditures to the government takes no account of the precise nature of any change. This, in turn, could cause changes in taxpayers' behaviour and in the level of overall economic activity. Consequently, eliminating a tax expenditure will not necessarily raise the entire amount of foregone revenues estimated below.

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Major Income Tax Expenditures (1991)

	(millions of dollars)
Non-taxation of lottery and gambling winnings	860
Education and tuition fee credits	314
Married/equivalent to married credit	1,665
Partial inclusion of capital gains	1,080
Non-taxation of employer-paid premiums for group private health plans	830
Non-taxation of workers' compensation payments	695
Age and pension income credits	1,600
Tax assistance for retirement savings	14,915
$500,000 lifetime capital gains exemption on small business shares	585
Charitable donations credit	845
Low tax rate for small businesses	2,037
Low tax rate for manufacturing and processing	353
R&D investment tax credit	543
Accelerated write-off for exploration and development	465

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Federal Spending on Unemployment Insurance

How much is spent on Unemployment Insurance (UI)?

$19.8 billion in total costs in the 1993 calendar year.

Who qualifies for UI?

Workers who lose their jobs or are unable to work because of maternity, parental obligations or sickness.

To qualify, workers must have been engaged in "insurable employment" and have made UI premium contributions. Self-employment (except for fishermen) and employment of less than 15 hours a week with earnings below a certain minimum do not qualify as "insurable employment".

How many Canadians are covered?

Over **90 per cent** of paid Canadian workers.

How many received UI benefits in 1993?

3.4 million individual Canadians.

What is the frequency of claims?

About 40 per cent of people receiving UI in 1993 claimed benefits at least three times in the previous five years.

How much is spent on benefits?

$18 billion in total benefits in 1993. This includes $14.3 billion in regular UI benefits; $1.3 billion in maternity/parental leave benefits; $0.4 billion in sickness benefits; $0.3 billion in fishing benefits; and $1.8 billion in development benefits (i.e. income support while on approved training, course costs and allowances, self-employment, mobility, job sharing and job creation).

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Are there other costs to UI?

$1.8 billion for administration and related costs.

How is UI funded?

Since 1990, UI has been funded entirely by premiums – **$18.5 billion in 1993** – paid by employers and employees, with employers paying 1.4 times the employee premium rate.

Does UI pay for itself?

The account is designed to be self-sustaining although annual deficits or surpluses in the UI Account can occur and are added to, or subtracted from, the federal deficit.

Premium rates are adjusted to balance the Account over time.

What is the size of the UI deficit?

In 1993, there was an annual deficit of **$1.2 billion**. This brought the accumulated deficit in the UI Account to **$5.9 billion** by the end of 1993.

How much is spent on related government assistance programs?

$1.4 billion under the Canada Jobs Strategy to provide labour market assistance, including assistance for those not eligible for UI.

$89 million for Older Worker Adjustment to provide long-term support to laid-off older workers.

Reforming the System

Important structural changes were made to the Unemployment Insurance Program in the February 1994 budget. These changes were the first step.

In the discussion paper, *Improving Social Security in Canada*, proposals are advanced which would bring about further structural changes to the current unemployment insurance program, and result in additional significant reductions in expenditures for two purposes: to lower premium rates and enhance employment development services.

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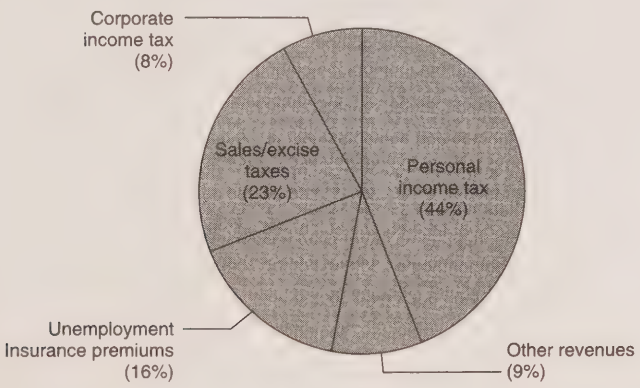
Federal Government Revenues

How much did people and businesses pay?

$116 billion – Federal government budgetary revenues in 1993-94.

What were the different revenue sources?

Federal revenue mix 1993-94



"Other revenues" include items such as return on investment (Bank of Canada profits, interest income, etc.) and other miscellaneous tax and non-tax revenues.

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Dollar-value of federal revenue sources

	($ billions)
Personal income tax	51.1
Corporate income tax	9.8
Unemployment Insurance premiums	18.2
Sales/excise taxes	
Goods and Services Tax	15.7
Sales and excise taxes/duties	10.9
Other revenues	
Other tax revenues	1.6
Non-tax revenues	8.7

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Personal Taxation

How much do Canadians pay?

$65.3 billion – was paid in personal taxes and social security levies to the federal government in 1993-94. This included:

$51.0 billion – in federal personal income taxes;

$ 7.6 billion – in employee Unemployment Insurance premiums;

$ 6.7 billion – in individual contributions to the Canada/Quebec Pension Plans.

How does Canada compare with the U.S.?

International comparisons of personal taxation include both income taxes (combined federal and provincial) and social security levies (such as unemployment insurance premiums). As a share of yearly economic output (the GDP), Canada's personal tax burden is higher than the United States.

1992	Personal income tax (as per cent of GDP)	Personal social security levies (as per cent of GDP)	Total
Canada	14.5	2.0	16.5
U.S.	10.1	3.9	14.0

However, in Canada, the universal health care system is publicly funded – while in the U.S., health care is an additional cost that must generally be paid for privately. As well, Canada's federal government supports post-secondary education to a much greater degree than the U.S. federal government.

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How 'progressive' is Canada's personal income tax system?

The Canadian income tax system is based on the principle of progressivity – that Canadians who enjoy higher incomes should carry a larger share of taxation. The following chart illustrates how the personal income tax burden (combined federal and provincial) is divided among Canadian tax-filers at different income levels.

Distribution of federal and provincial personal income tax burden – 1992

Income level	Share of all tax-filers	Share of personal income	Share of total tax paid
		(per cent)	
$0 – $25,000	62	28	9
$25,000 – $50,000	28	39	40
$50,000 – $100,000	9	23	33
$100,000 and over	1	10	18
Total	100	100	100

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Corporate Taxation

How much tax do corporations pay?

$51 billion – was paid by corporations in 1993 to all levels of Canadian government. This is an increase from $36 billion (in 1993 dollars) paid in 1980. Of these tax revenues:

> **$21 billion** – went to the federal government through corporate income taxes, capital taxes, the Large Corporations tax, Unemployment Insurance premiums, and Canada Pension Plan contributions.
>
> **$30 billion** – went to provincial and municipal governments through corporate income taxes, capital and insurance premium taxes, workers' compensation levies, and municipal property taxes.

What about corporate income taxes?

$9.8 billion – was the value of corporate income tax payments to the federal government in1993-94. This provided 8 per cent of all federal budgetary revenues.

By comparison, in 1983-84, corporate income taxes provided 11 per cent of federal revenues.

A major factor in this relative decline has been the depressed state of corporate profits due to the recent recession. As corporate profitability improved in late 1993, corporate income tax payments also increased.

In 1993, corporations paid approximately 40 per cent of their profits in federal and provincial income taxes.

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Are large corporations paying a reasonable share of taxes?

Changes to the corporate tax system over the last decade have broadened the corporate tax base and reduced the opportunity for corporations to avoid paying taxes on their profits.

All large corporations (with more than $10 million in Canadian capital) must pay the federal Large Corporations Tax. This provided the federal government with $1 billion in revenue in 1991.

Banks and other large financial institutions are also subject to an additional tax on their capital. In 1991, chartered banks paid $900 million in federal income taxes (including the Large Corporations Tax and capital taxes).

Overall, in 1993, total taxes paid by Canadian corporations was equivalent to two-thirds of their profits before taxes. This was almost 50 per cent more than in 1988 – largely due to increases in taxes that are not tied to profit (such as provincial payroll and municipal property taxes).

What about companies that pay no income tax?

Most profitable corporations do pay federal income tax and all large corporations pay the Large Corporations Tax. Ninety per cent of the business income earned by profitable corporations in 1990 (the latest year for this information) was subject to taxation. The equivalent figure in 1986 was 75 per cent.

The majority of profitable corporations not paying income tax are only marginally profitable. In 1990, half of these firms had business income lower than $5,000 – and another quarter had incomes under $25,000.

In cases where profitable corporations do not pay income tax, the main reason is the carry-over of losses from previous years. This recognizes the variations in the business cycle, and the fact that corporate profitability is better measured over a number of years than in a single period.

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The Goods and Services Tax (GST)

What is the GST?

The GST is a 7-per cent value-added tax applied to the vast majority of goods and services sold in Canada for domestic consumption. The GST does not apply to basic groceries, most medical services and devices, prescription drugs, residential rents and exports.

How much revenue does the government receive from the GST?

$18.4 billion – in 1993-94 after rebates and refunds to public sector bodies, such as hospitals, schools and municipalities; to charities and non-profit organizations; to new home buyers; to GST registrants claiming Input Tax Credits for business purchases; and to foreign tourists.

What does the government do with GST revenues?

$15.7 billion – in 1993-94 went to help pay the annual interest costs on government borrowing.

$2.7 billion – was returned to some 8.5 million low- and modest-income individuals and families in the form of the GST Credit. It is not considered income for the purposes of income taxation.

How many companies and self-employed individuals are registered to collect the GST?

2 million approximately.

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Does that include every company and self-employed individual in Canada?

No. Small businesses and self-employed individuals with annual revenues under $30,000 may opt not to register. The Small Traders Exemption enables these companies and self-employed individuals not to charge the GST on sales of their goods and services while foregoing eligibility for Input Tax Credits.

What is the difference between the GST and provincial sales taxes?

Unlike provincial sales taxes, the GST has an Input Tax Credit mechanism which effectively removes federal sales tax on the purchase of business inputs (Quebec also has an input tax credit system which removes the Quebec sales tax paid on most business purchases). This ensures that the federal sales tax system does not put Canadian businesses at a disadvantage when competing against foreign goods and services in either the domestic or international markets.

The GST also applies to most services. Most provinces (except Quebec, which has largely harmonized its sales tax system with the GST) apply their sales taxes to a very narrow range of services.

Why does the federal government want to replace the GST?

The federal government is committed to replacing the GST with a tax that is fairer for consumers, easier for businesses to comply with and more cost efficient for government to administer.

What form will a new sales tax take?

This has yet to be determined. The federal government has proposed a 12 per cent integrated value-added tax. The federal rate would be 5 per cent and the provinces would set their sales tax rates at 7 per cent. The key features of the federal proposal include: a single, lower, combined federal-provincial sales tax rate; a common tax base (including the same items as the GST); the GST low income credit maintained at its current level; and federal measures to offset the revenue impacts of a reduced federal sales tax rate.

Discussions between the federal government and the provinces on the design and implementation of a replacement are ongoing.

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The New Economy and What It Means for Canadians

What is the new economy?

"New economy" is a term used to describe several fundamental developments in the world economy. The new economy and all that it implies is having a profound effect on economic growth and job creation in Canada.

What kind of developments are we talking about?

...globalization

National and regional markets are integrating into a vast global market. This has happened because of revolutionary advances in communications and transportation, together with more open, market-oriented trade and investment policies. The development of a global financial market, the rapid spread of the latest technologies and management techniques, and the growth of new market economies in developing countries are contributing to global integration.

...developing regions

Dynamic new competitors, and new markets, are emerging in parts of the developing world such as the Pacific Rim and parts of Latin America. The new challengers include Korea and China as well as Mexico and Chile. Overall, these new regions could add one or two billion new producers/consumers to the global market economy over the next 20 to 30 years.

...the information economy

Another major trend is the rise of the "information economy" – dominated by specialized, knowledge-based industries such as the computer and pharmaceutical sectors. In the advanced countries, information is replacing energy and raw materials as the key resource in the creation of economic value.

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Is this good for Canada?

The new economy offers both opportunities and challenges for Canadians. New markets for Canadian goods and services are opening everywhere. But the scope and intensity of economic competition is increasing just as fast.

Can Canada compete?

Canada has great competitive advantages including: an advanced economy, a skilled workforce, superior physical and social infrastructure, and sophisticated industries whose products are in great demand in developing regions – e.g., telecommunications, engineering consulting. But Canada must boost productivity and market aggressively to remain competitive and take advantage of the increased demand for goods and services on the world market.

What does this mean for job creation?

Increased competition, particularly from low-wage economies, is one of the many factors affecting employment and economic growth around the globe. Between 1990 and 1993, for people with high school education or less, 640,000 jobs were lost. But for those with education beyond high school, 450,000 jobs were **gained**. Other factors influencing job creation will be increased exports as markets grow and greater demand for skilled people in the booming services sectors, such as telecommunications and computer software.

What are the implications of the new economy for Canada?

As part of a new economic strategy, Canadians must address emerging issues in several key areas:

Canada must build on its strengths to **attract investment**, particularly from companies offering research and development or with mandates to produce goods for world markets.

Resource industries are not the "guarantee" of wealth they once were. Canadian producers will be required to continuously upgrade their technological sophistication and diversify their products and markets.

New export opportunities must be enhanced with export financing, joint venture arrangements and government-to-government negotiations.

Canada's **information industry** has the potential to be a world leader in many new applications – e.g., in finance, entertainment, health care. Encouraging regulatory policies and an attractive business environment will increase Canada's comparative advantage.

How does Canada start to meet the challenges and seize the opportunities?

The government must ensure that Canadians have opportunities and incentives to acquire new skills and adapt to economic change. As well, innovative new investment should be encouraged. Creating this kind of economic environment is the responsibility not only of governments and public institutions, but also of business, labour and individual Canadians.

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Creating More and Better Jobs

The number-one economic objective of the government is to create more and better jobs for Canadians. For 20 years, the average rate of unemployment has been rising. Measures must be taken to reverse this trend and to restore the growth of average incomes, which have stagnated in real terms during the past 15 years.

Unemployment

By international standards, Canada has had an excellent rate of job creation, the highest on average among the major industrialized countries during the past 20 years. But the workforce has grown even faster, causing average unemployment to rise.

It is common for the unemployment rate to rise and fall with the business cycle, increasing during downturns and decreasing during recoveries.

However, the core rate of unemployment has risen substantially since the early 1970s in the sense that economic recovery after recessions has left unemployment higher than before recessions.

Four factors have caused the core rate of unemployment to rise.

- **Skills mismatches**: In the transition to a more knowledge-based economy, those lacking the education, the new specialized skills and the flexibility to adapt are increasingly frozen out of the job market.
- **Disincentives in income security programs**: Income security programs (e.g., UI, social assistance) are necessary, but they contain features that can discourage the active search for work and can encourage employers to arrange patterns of layoff and re-hire that maximize the use of publicly-financed programs.
- **Payroll taxes (e.g., UI premiums)**: These increase wage costs for employers and decrease the take-home pay of employees. They make a wage bargain harder to reach and discourage job creation.
- **Severe recessions**: The 1981 and 1990 recessions were severe both in their depth and the time it took for employment to recover. Longer-than-usual unemployment associated with these downturns eroded job skills and confidence, thus diminishing the likelihood of re-employment as the recoveries strengthened.

Reversing the growing prevalence of long-term, structural unemployment will require:

- skilled and adaptable workers to build the smarter, more productive economy on which jobs and income growth depend;

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- redesigning income support programs to minimize disincentives;
- reversing the steady rise of payroll taxes;
- keeping inflation under control and restoring the government's fiscal capacity to lessen the severity of cyclical downturns.

Job Creation

Creating more and better jobs for Canadians depends on:

- stronger, sustained economic growth, flowing from increased productivity (on average, there has been no productivity growth in Canada between the late 1970s and 1993);
- the ability and willingness of individuals and businesses to embrace new opportunities and to innovate. Productivity growth – and thus the growth of incomes and jobs – relies on this fundamental process of adaptation in which there are always new and more productive activities superseding the old.

Today, these opportunities exist in a challenging new context created by the end of the Cold War and by the emergence of an interdependent global economy in which knowledge and the ability to shape information define the cutting edge of economic progress.

The federal government's strategy to promote economic growth and job creation is based on five policies:

- **Helping Canadians acquire skills** to build a more productive economy, to foster better job opportunities, and to establish the basis for life-long personal development.
- **Encouraging Canadians to adapt to new opportunities** to minimize long-term and repeated joblessness and to ensure that businesses and individuals face the right incentives to take advantage of more productive opportunities.
- **Getting government right** to ensure that government itself, through efficient management and appropriate policies, contributes all it can to a more productive economy.
- **Providing leadership in the economy** to build a more innovative and outward looking economy through actions that government, in partnership with the private sector, is in the best position to take (e.g., support of science and technology, tax incentives for research and development, fostering diffusion of technology to smaller firms, and ensuring open and expanded markets for Canadian exports).
- **Creating a healthy fiscal and monetary climate** to establish the broad economic conditions for sustained growth and job creation and to ensure that the government will have both the resources and the degree of public trust needed to succeed in the other four policy directions.

Fostering an economy that provides better jobs and a rising standard of living will require:

- active and smart government, but not "big government";
- co-operative government committed to partnership with provinces, the private sector, communities and individual Canadians;
- a government that can focus its energies where they are most needed and possesses the will to live within its means.

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Productivity – Key to Growth and Jobs

What is productivity?

"Productivity" is the term used to describe how well ideas, workers, resources and investment are combined to produce goods and services in the economy. In short, productivity growth boils down to getting more out of less.

Productivity is improved through the ingenuity of the work force, the quality of management, the ability of entrepreneurs, and the advancement of knowledge and technology.

Why is productivity important?

Productivity growth means higher output at lower cost. This translates to new markets and higher incomes – i.e. to growing demand in the economy. Growing demand creates new jobs.

How is productivity measured?

The broadest measure of productivity is the amount of output (the value of goods and services) per unit of labour and capital combined. Productivity grows, for example, when more output is produced in the same number of working hours using equipment of the same dollar value.

Doesn't higher productivity mean higher unemployment?

No, quite the contrary. Innovation and productivity gains can displace people from certain jobs, but overall, productivity growth throughout history has always been a net creator of jobs. Unemployment in Canada was much lower during the years of extraordinary productivity growth from 1953 to 1973, just as it is low in the dynamic new economies of Asia, where productivity gains are high today.

Productivity leads to more competitive businesses which can therefore expand their markets and create more jobs. Higher productivity growth also leads to higher real incomes and therefore to more spending in the economy. This generates job growth in a wide range of businesses – from restaurants to car dealerships – that may be far removed from the original source of productivity improvement.

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What affects a nation's productivity?

Many factors affect the level of productivity including the education and skills of workers, the quality of technology being used by firms, the skill of management; market factors such as access and competition; attitudinal factors, such as commitment and vision; and other factors, such as labour/management relations.

Is Canadian productivity low?

No, the level of Canadian productivity is not low. If it was, Canada would be a much poorer country. But Canada's productivity growth, like that of many other industrial countries, has slowed sharply since the early 1970s. As a result, average real wage growth has virtually stopped, and economic growth overall has slowed considerably. Canada's productivity performance will need to improve significantly in order to increase the growth of jobs and incomes.

How can the government support productivity growth?

The government must ensure that Canadians have opportunities and incentives to acquire new skills and adapt to economic change. New investment should be encouraged – e.g., firms should be helped to identify the best technologies and techniques. Export markets should be expanded. Creating this kind of economic environment is the responsibility not only of governments and public institutions, but also of business, labour, and individual Canadians.

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The Federal Program Review

What is the Program Review?

The government is conducting a fundamental review of all federal programs and activities including grants and contributions, tax expenditures, cost-recovery and overhead.

The goal of the review is a more effective, smaller and affordable government which concentrates on its core roles and responsibilities.

Not included in the Program Review are the major statutory transfer payments to provinces and to people. Most of these are being examined separately – e.g., in the review of social security.

What are the guidelines for the Program Review?

Each government department and agency has been asked to review and assess its activities and programs against the following six guidelines:

- Does the program area or activity continue to serve a public interest?
- Is there a legitimate and necessary role for government in this program area or activity?
- Is the current role of the federal government appropriate or should the program be transferred to the provinces?
- What activities or programs should or could be transferred, in whole or in part, to the private or voluntary sector?
- If the program continues, how could its efficiency be improved?
- Is the program affordable in light of the current fiscal situation?

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What will be the outcome of the Program Review?

Some programs and services will be streamlined and some may be eliminated – particularly those that can be provided more efficiently by the private sector or that overlap with services provided by other levels of government.

While the result will be a smarter and more affordable government, it will continue to provide those programs and services that protect the vulnerable in society.

What is the time frame for the Program Review?

Some decisions will be taken through the fall and announced in the 1995 budget. The review will also lead to changes which will have to be implemented over several years.

What other reviews are in progress?

A number of more specific reviews announced in the 1994 budget are underway to complement the Program Review, including:

- **Social Security Reform**, in co-operation with the provinces, aims to create an affordable system that enhances employability and fosters independence by offering incentives to work while protecting the most vulnerable.

- **The Science and Technology Review** is examining ways to maximize the benefits to the economy of the substantial federal in-house research capability and the government's extensive programs to encourage S&T activities in universities and businesses.

- **The Defence and Foreign Policy Reviews** will ensure that Canada's objectives in the future are more clearly defined and accomplished in a cost-effective manner.

- **The Small Business Review** will determine how the federal government can best foster the growth of small- and medium-sized enterprises.

In addition, the government is reviewing its funding support to special interest groups and has also launched a number of special policy assessments, several of which cut across the mandates of many departments – e.g., reviews of sustainable development and regulatory reform.

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Privatization

What is meant by privatization?

"Privatization" is the term used when the government transfers ownership of its Crown corporations and other corporate holdings and assets to the private sector.

What are the possible benefits of privatization?

- Improved efficiency of the privatized companies as they operate under market discipline.
- Enhanced competition and investment. True competition is difficult to achieve in any sector where publicly-owned industry has a major stake. Privatized corporations also create investment opportunities, since they are free to borrow on their own merits to finance their expansion/development requirements.
- More efficient government. Privatization reduces government time and resources spent on managing assets that are, in many cases, better suited to operate in the private sector. In addition, successful privatization reduces demands on the public treasury and frees scarce resources for other government priorities.
- Opportunity for Canadians to invest as shareholders. Canadians can invest directly in major Canadian corporations they previously supported as taxpayers. As well, share ownership plans allow employees of privatized companies to participate directly in the success of their companies.

Why doesn't the government reduce the deficit by privatizing Crown corporations?

Privatization does not necessarily lead to deficit reduction, particularly in the short term. The deficit would only be reduced if the selling price exceeds the value at which the asset is carried in the government's books. In the longer term, privatization could reduce the deficit by reducing the government's borrowing requirements and thus decreasing debt servicing costs.

What is the difference between "privatization" and "commercialization"?

Generally speaking, commercialization means adopting a business-like approach to the delivery of certain public services in order to improve service and reduce costs, while protecting the public interest. For instance, under the new National Airports Policy, Canada's 26 busiest airports will be leased to local, not-for-profit organizations that will manage them to self-sufficiency within five years.

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Commercialization embraces a number of possibilities for owning and operating assets, including Crown corporations, ‘mixed’ private-public enterprises, transfers to other levels of government, as well as privatization, which involves the outright transfer from the public to the private sector.

How does the government decide if a corporation should be privatized?

Potential candidates are initially assessed on a case-by-case basis against two key criteria – does the corporation serve public policy objectives for which government ownership is still required and does the company have the potential to be commercially viable?

If these criteria are met and Cabinet approves the sale, divestiture legislation is prepared to authorize the sale and, where appropriate, to legislate limits on individual or foreign ownership. Final authority from Parliament must be received before any proposed sale of a Crown corporation can be finalized.

How many Crown corporations does the government own?

The government owns 48 parent Crown corporations, which have 62 wholly-owned subsidiaries. Examples include:

Atomic Energy of Canada Limited; Bank of Canada; Canada Deposit Insurance Corporation; Canada Mortgage and Housing Corporation; Canada Post Corporation; Canadian Broadcasting Corporation; Canadian Museum of Civilization; Canadian National Railway Company; The Canadian Wheat Board; Cape Breton Development Corporation; Export Development Corporation; Marine Atlantic Inc.; Royal Canadian Mint; Vancouver Port Corporation; and VIA Rail Canada Inc.

How many corporations have been privatized?

In the past decade, 23 privatization initiatives have been undertaken – including parent Crown corporations, subsidiaries and holdings in mixed-ownership corporations. Examples include:

Canada Development Corporation; The de Havilland Aircraft of Canada Limited; Canadair Limited; Teleglobe Canada; Fisheries Products International Limited; CN Hotels; Air Canada; Petro-Canada; and Telesat Canada Inc.

With what results?

Some 52,000 employees have been transferred to the private sector.

Proceeds from sales have raised $4 billion.

What is done with the proceeds from privatizing Crown corporations?

The net proceeds from privatization go to help pay the annual interest costs on government borrowing.

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